Financial Services Authority

FINAL NOTICE

To:	**Mr Ceri Rees**
Individual ref:	**CTR00006**
Address:	**1 Caspian Point** **Pier Head Street** **Cardiff** **CF10 4DQ**
Date:	**25 November 2010**

TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS ("the FSA") gives you, Mr Ceri Rees, final notice about the imposition of a financial penalty, the withdrawal of your individual approval and the making of two prohibition orders:

1. ACTION

1.1. On 25 November 2010 the FSA gave you a Decision Notice which stated that it had decided:

(1) pursuant to section 66 of the Financial Services and Markets Act 2000 ("the Act"), to impose on you a financial penalty of £17,500 for failing to comply with Statements of Principle 2 and 7 of the FSA's Statements of Principle and Code of Practice for Approved Persons ("Statements of Principle");

(2) pursuant to section 63 of the Act, to withdraw the approval given to you to perform the significant influence functions of CF4 Partner, CF10 Compliance Oversight and CF11 Money Laundering at Clark Rees LLP (the "LLP") because you lack the competence and capability to perform these functions;

(3) pursuant to section 56 of the Act, to make an order prohibiting you from performing any significant influence function in relation to any regulated activity carried on by any authorised person, exempt person or exempt professional firm (the "Prohibition Order"); and

(4) to make a further order, pursuant to section 56 of the Act, prohibiting you for a period of two years from the date of this notice from performing all customer functions (CF30) in relation to sales of unregulated collective investments schemes ("UCIS") (the "Time Limited Prohibition Order").

1.2. You agreed to settle this matter at an early stage of the FSA's investigation and you therefore qualified for a 30 per cent (Stage 1) discount under the FSA's executive settlement procedures. Without this discount, the FSA would have sought to impose a financial penalty of £25,000 on you.

2. REASONS FOR THE ACTION

2.1. Between 15 November 2007 and 22 October 2009 ("the relevant period"), you were approved by the FSA to perform the controlled functions of CF4 (Partner), CF10 (Compliance Oversight), CF11 (Money Laundering Reporting) and CF30 (Customer) at the LLP. You were also approved to perform the controlled function of CF8 (Apportionment and Oversight) between 15 November 2007 and 31 March 2009.

2.2. For the reasons set out more fully in section 4 below:

(1) you failed to act with due skill, care and diligence in carrying out your controlled functions (in contravention of Statement of Principle 2) by:

(a) failing to inform yourself about and demonstrate an understanding of the regulatory requirements relating to the promotion of UCIS and, in particular, you were not aware of the statutory restriction on the promotion of UCIS in section 238 of the Act ("the section 238 restriction") and the exemptions to that restriction; and

(b) failing to inform yourself about and apply correctly the rules relating to regulatory capital requirements; and

(2) you failed to take reasonable steps to ensure that the business of the LLP for which you were responsible in your controlled functions complied with the relevant requirements and standards of the regulatory system (in contravention of Statement of Principle 7) by failing to:

a) ensure that the LLP had regard to the section 238 restriction and any relevant exemptions to it before promoting UCIS to its customers;

b) take reasonable steps to ensure that the LLP's personal recommendations to its customers to invest in UCIS were suitable (including a failure to meet the information gathering requirements in section 9 of the FSA's Conduct of Business Sourcebook ("COBS"));

c) demonstrate an understanding of the Treating Customers Fairly principles;

d) ensure that, when handling complaints, the LLP was organised so that it could identify and remedy any recurring or systemic problems;

e) ensure that the LLP adequately disclosed and managed a potential conflict of interest arising from the involvement of both partners in a UCIS into which customers of the LLP were advised to invest;

f) ensure that the LLP's advisers were properly supervised and had the competence, knowledge, and skills to give investment advice;

g) ensure that the LLP had adequate financial resources and met its regulatory capital requirements since it became authorised by the FSA;

h) ensure that the LLP submitted its Retail Mediation Activities Return to the FSA in a timely and accurate manner; and

i) ensure that the LLP dealt with the FSA in an open and co-operative way, by disclosing matters relating to it of which the FSA would reasonably expect notice.

2.3. The FSA concluded that your conduct was particularly serious because your failures exposed customers to a risk of receiving unsuitable recommendations in relation to retail investment products.

2.4. Due to your failure to take reasonable steps to ensure that the LLP retained appropriate records to demonstrate whether its advisers assessed and, if so, the basis on which its advisers assessed the suitability of the products they recommended, the FSA was unable to satisfy itself that customers were recommended suitable investment products.

2.5. The FSA concluded that your conduct during the relevant period demonstrated that you had failed to comply with Statements of Principle 2 and 7, for which a financial penalty is appropriate. The FSA also concluded that you lack the competence and capability to perform significant influence controlled functions at the LLP, and therefore you were not a fit and proper person to perform any significant influence functions in relation to regulated activities carried on by authorised persons, exempt persons and exempt professional firms. It was therefore also necessary and proportionate to withdraw your individual approval and to make a prohibition order and a further time limited prohibition order, in support of the FSA's consumer protection and market confidence objectives.

3. RELEVANT STATUTORY AND REGULATORY PROVISIONS

3.1. The relevant statutory provisions and regulatory requirements are set out at Annex A.

4. FACTS AND MATTERS RELIED ON

Background

4.1. The LLP was a small investment partnership based in Cardiff. With effect from 15 November 2007, the LLP was authorised by the FSA to carry on the following regulated activities:

(1) advising on investments (excluding pension transfers/opt outs);
(2) agreeing to carry on a regulated activity;
(3) arranging deals in investments; and
(4) making arrangements.

4.2. The LLP was set up as a limited liability partnership and run by you and Mr Paul Clark. On 7 May 2009 Mr Clark withdrew his approved person status. On 22 October 2009, you voluntarily varied the LLP's permission by adding a requirement that it would not undertake any regulated activity. The LLP conducted a low volume of regulated business, completing 50 retail investment sales between 15 November 2007 and 15 July 2010. It had approximately 70 customers of whom 11 invested in one or more of three UCIS.

4.3. During the relevant period, you and Mr Clark were the partners and the approved persons performing significant influence functions at the LLP. During the relevant period, there were between two and four investment advisers at the LLP, including you and Mr Clark. You were both responsible for the day-to-day running of LLP and for the decision making. Accordingly, you were jointly responsible for taking reasonable steps to ensure that the business of the LLP was organised so that it complied with regulatory requirements and the standards of the regulatory system.

4.4. On 8 October 2009, the FSA visited Clark Rees LLP. During the visit, the FSA reviewed a sample of 16 electronic client files and noted the absence of key

information on the client files relevant to demonstrating the suitability of personal recommendations made by the LLP's advisers. The FSA also identified a number of serious concerns about the promotion of and personal recommendations to invest in UCIS, and the management and disclosure of a conflict of interest, and the adequacy of the LLP's capital resources.

4.5. For the reasons set out below, the FSA concluded that the LLP fell below the standards expected of authorised firms.

Promotion of UCIS

4.6. The section 238 restriction prohibits authorised persons from communicating an invitation or inducement to participate in a collective investment scheme. There are a number of exemptions to the section 238 restriction which an authorised firm could rely on to promote UCIS to its retail customers.

4.7. By not paying due regard to the statutory and regulatory restrictions on the promotion of UCIS before recommending its customers to invest in UCIS, the LLP may have acted unlawfully and potentially exposed its customers to the risk of receiving unsuitable investment advice. It failed to comply with Principle 9 of the FSA's Principles for Businesses ("the Principles") which requires it to take reasonable care to ensure the suitability of its advice for any customer who is entitled to rely upon its judgment. As senior management at the firm, you were responsible for these failings.

4.8. The relevant regulatory provisions relating to UCIS are summarised in Annex B to this Notice.

4.9. The FSA identified 11 customers who were advised by the LLP to invest in one or more of three UCIS. One of the UCIS ("the Scheme") was a scheme that was set up by you and Mr Clark. The FSA found no evidence that the LLP had correctly applied the relevant exemptions before promoting UCIS to customers, thereby contravening the section 238 restriction.

4.10. On 18 March 2010, you admitted that you were unaware of the statutory and regulatory restrictions relating to UCIS and you failed to demonstrate an adequate understanding of the specific requirements regarding client certification (such as the requirements for certifying customers as high net worth individuals). You told the FSA that all letters issued to UCIS customers until May 2009 incorrectly described them as "*sophisticated and experienced investors*" instead of referring to the exemption categories in the Financial Services and Markets Act 2000 (Promotion of collective investment schemes) (Exemptions) Order 2001 ("the PCIS Order") and/or the categories in COBS 4.12. The FSA found no evidence that customers of the LLP had been categorised in accordance with the PCIS Order or COBS 4.12 before they received UCIS promotions from the LLP.

4.11. You also failed to ensure that the LLP made personal recommendations to its customers to invest in UCIS without first adequately assessing and documenting the customers' personal and financial circumstances and knowledge and experience of this type of investment.

Suitability

4.12. You failed to take reasonable steps to ensure that the LLP made suitable recommendations to its customers, placing the LLP in contravention of COBS 9.2.1R. The FSA found no satisfactory evidence that the LLP's advisers had complied with the requirements in COBS 9 as there was an absence of key information on client files such as fact finds, product research and suitability letters. You said that, upon migrating data to a new electronic record keeping system, a number of key documents had gone missing. You provided the investigation team with missing documentation in March 2010. The FSA reviewed the additional documentation and identified the following deficiencies in the fully assembled client records:

(1) there were missing documents and inadequate information on client files to demonstrate the adviser's awareness and understanding of the customer's financial circumstances, investment objectives and knowledge and experience of financial products (and you accepted that manuscript notes had been destroyed and that certain information such as customers' objectives, assets, liabilities and attitude to risk were missing from fact finds which you attributed to data loss);

(2) there was insufficient evidence of product research, consideration of alternative products and/or independent due diligence on files, and no evidence of research to compare the recommended product with the customer's existing investment in cases where transfers/switches had been recommended;

(3) in some cases, the advice was inconsistent with the customers' stated needs and preferences and you accepted that it was not clear in one file how the recommended UCIS met the customer's objectives;

(4) assessments of customers' attitude to risk were missing or inadequate, and there was insufficient evidence to show that customers understood the risks involved in recommended transactions;

(5) there were no documented assessments of the risk of exposing significant proportions of customers' assets to UCIS investments;

(6) there was no evidence of a policy on the diversification of customer portfolios to mitigate the risks associated with investments in UCIS and manage concentration risk;

(7) one customer who was near to retirement invested 60% of his portfolio in UCIS and another retired customer invested 55% of his (tax-free) retirement lump sum in UCIS and, in both cases, there was no evidence to show that they could tolerate a partial or the complete loss of capital invested; and

(8) there was insufficient evidence on files to demonstrate suitability and UCIS customers were issued with letters wrongly classifying them as "sophisticated and experienced investors", with insufficient explanations as to how the recommended product was suitable for them.

4.13. As a result of the failings in the LLP's sales process identified above, at least 11 customers were exposed to the risks of receiving unsuitable advice and put in a position in which they made investment decisions based on incomplete and/or misleading information.

Capital adequacy and reporting failures

4.14. The LLP's Retail Mediation Activity Return ("RMAR") for the period ended 31 March 2008 showed that it had wrongly relied on the partners' personal assets to meet the capital requirements. You said that you had included the partners' personal assets in support of the evidence in the LLP's FSA authorisation application that it was satisfying Threshold Condition 4 (Adequate resources). You said that it was only after you received a letter from the FSA questioning the inclusion of these assets that you became aware that personal assets could not be included for a limited liability partnership. You said that the LLP had been advised incorrectly by e-mail on this matter by an external compliance consultant, but you were unable to find the e-mail.

4.15. To rectify the deficit, you provided a member's capital agreement that showed initial capital of £13,779. You also provided accounts that showed a balance on the partners' account of £16,801 as at 28 February 2007. However, the LLP's financial statements for the year ended 31 March 2007 showed a balance on the partners' account of £(191,438). The LLP failed to comply with a document request dated 2 June 2010 relating to this discrepancy.

4.16. As at September 2009, the LLP had failed to submit RMARs for the periods ending 30 September 2008 and 31 March 2009. You stated that this was an oversight and that the reminders had failed to appear in your diary because of the LLP's IT problems.

4.17. When the LLP submitted the late RMARs to the FSA on 28 September 2009, it was evident that both returns had incorrectly double-counted the net profits (i.e. the net profits were included as a separate item in the capital resources calculation when they had already been included as part of the balance on the partners' accounts). You failed to explain to the FSA's satisfaction why this had occurred and you said that you would speak to the LLP's accountant about it. On 20 April 2010, the FSA sent an

information request regarding this issue. You failed to ensure that the LLP complied with the request.

4.18. A review of the information underpinning the March 2009 RMAR identified the inclusion of a debt owed to the LLP by a connected company, Company A. You and Mr Clark were also directors of Company A and as such you knew they had no realistic prospect of recovering the debt because that company had gone into administration. When the LLP revised its accounts and removed the debt, it was evident that it did not have sufficient capital. You told the FSA that you reviewed the RMARs prior to their submission but that you relied on the LLP's accountant to understand what was required.

4.19. The LLP's complaints returns for the reporting period April to September 2008 and October 2008 to March 2009 were incorrectly completed and inconsistent with the LLP's own complaints register.

4.20. You therefore failed to act with due skill, care and diligence by failing to inform yourself about the FSA's capital requirements and to take reasonable steps to ensure that the LLP met its capital requirements. You failed to ensure that the LLP submitted accurate and complete reports to the FSA by the due date, in breach of paragraph 16.12 of the FSA's Supervision manual ("SUP") and complied with all statutory information and document requests.

Potential conflict of interest

4.21. The Scheme was an offshore UCIS set up by you and Mr Clark in 2008. You were also the two directors of the investment manager for the Scheme. In December 2009 you resigned from the investment manager as a director and shareholder. As the founder shareholders of the Scheme, you had the right to appoint and replace the directors. The Scheme's Private Placement Memorandum ("PPM") dated 28 July 2008 stated that the Scheme would pay the investment manager fees for its services. During the relevant period, the Scheme invested in a particular partnership on the investment manager's recommendation.

4.22. While the partners were directors of the investment manager, which was responsible for the Scheme's investment management operations, the LLP promoted the Scheme to some of its customers and purported to provide them with independent advice in relation to it. Since December 2008, eight customers invested in the Scheme.

4.23. Although the PPM recorded the Scheme's approach to potential conflicts of interest, the FSA considers that it did not adequately disclose the potential conflict of interest between the partners' investment management role for the Scheme and their role as independent financial advisers at the LLP. You confirmed that the PPM was the only

document in which the potential conflict was disclosed and considered that this disclosure was absolutely clear and sufficient to avoid a conflict. You stated that the investment manager had never received any payment from the Scheme, and that you considered that sufficient steps had been taken to manage the potential conflict.

4.24. In May 2009 you took another view of the potential conflict, which resulted in Mr Clark's resignation as an IFA from the LLP which he did on 7 May 2009. You stopped discussing the Scheme fund with the LLP's customers in June 2009, resigned from the investment manager as a director and shareholder and made arrangements for a new investment manager to replace the existing one. You remain an investor of the Scheme.

4.25. The FSA considered that between July 2008 and June 2009 your role as director of the investment manager represented a conflict of interest in respect of the independent of advice given by the LLP to its customers and the financial incentives to increase the funds under management by the investment manager. In addition, the LLP failed to manage this conflict and disclose it adequately to its customers before making personal recommendations to them to invest in the Scheme.

4.26. Given the significant influence functions performed by you, the FSA concluded that you were responsible for the LLP's failure to adequately recognise, disclose and manage this conflict of interest.

Misleading customer communications

4.27. The LLP issued letters to all customers who invested in UCIS which described them as "*sophisticated and experienced*", although the LLP purported to rely on the COBS 4.12 exemption categories. The letters stated that a customer should only invest in such holdings if they regarded themselves as a sophisticated and experienced investor. The LLP regarded these long-standing customers as sophisticated and experienced investors due to their attitude to risk and because they had built up money in pension funds and had other investments. In the letter, the LLP went on to state there was no clear definition of a sophisticated and experienced investor, and that the LLP considered that that a key component to this was that the customer must regard himself or herself as a sophisticated and experienced investor.

4.28. The FSA considered the letter to be misleading because:

(1) it gave customers the impression that they had been categorised as sophisticated and experienced when in practice no compliant assessments against these exemptions had been undertaken;

(2) "*sophisticated and experienced*" is not a category of exemption under the PCIS Order or COBS 4.12;

(3) there are two types of sophisticated investors referred to in the PCIS Order – certified and self-certified - and there are specific definitions and requirements for each type. However, you state in some of your suitability letters that you consider the customers as sophisticated investors because they hold pensions and investments; and

(4) the letters were confusing because they inferred that customers should assess their own eligibility for UCIS, yet they stated that the LLP also assessed them. Therefore it was difficult to determine whether the customer had been dealt with as a self-certified sophisticated investor or certified by a firm as a sophisticated investor.

4.29. You accepted that the letter to customers did not accurately reflect the prescribed requirements for a sophisticated investor.

4.30. The FSA concluded that you failed to ensure that the LLP communicated with customers in way that was clear, fair and not misleading, in breach of Statement of Principle 7.

Compliance management oversight

4.31. You were responsible for the compliance function at the LLP. The LLP did not engage an external compliance firm after it became authorised.

File checking

4.32. You failed to take reasonable steps to ensure that personal recommendations to 11 customers to invest in UCIS were properly monitored and the advisers adequately supervised. File reviews and discussions with advisers were not documented so you could provide no evidence that such reviews took place or that they were effective. You accepted that some fact find documents were incomplete and that some correspondence with customers was unclear. Mr Clark described file reviews and compliance checks as "ad hoc". You accepted that while some of your work was overseen by an adviser, other files were not reviewed at all.

4.33. The FSA concluded that, in practice, there was no formal process to ensure that files were adequately reviewed or a formal process to disseminate lessons learned in respect of each adviser and in respect of systemic issues.

Complaints

4.34. The LLP's approach to complaint handling was inadequate. As the LLP's complaints officer, you failed to ensure that all complaints were recorded as complaints. You showed a lack of understanding of complaint handling rules in that you stated that administrative matters were not considered to be complaints and that customers were asked to put complaints about advice in writing before they could be considered.

4.35. The FSA concluded that you failed to establish adequate compliance monitoring procedures to ensure that the LLP complied with the relevant requirements of the regulatory system.

Management information

4.36. The LLP also failed to adequately monitor business written. Consequently you failed to identify that the LLP's recommendations resulted in a high concentration of some customers' overall savings and investment portfolio in UCIS.

5. ANALYSIS OF THE SANCTIONS

Imposition of financial penalty

5.1. The FSA's policy on the imposition of financial penalties relevant to the misconduct as detailed in this Notice is set out in Chapter 6 of the version of the Decision Procedure and Penalties Manual ("DEPP") in force prior to 6 March 2010, which formed part of the FSA Handbook. All references to DEPP in this section are references to that version of DEPP.

5.2. The principal purpose of imposing a financial penalty is to promote high standards of regulatory conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches and demonstrating generally the benefits of compliant behaviour.

5.3. In determining whether a financial penalty is appropriate the FSA is required to consider all the relevant circumstances of a case.

5.4. DEPP 6.5.2G sets out a non-exhaustive list of factors that may be of relevance in determining the level of a financial penalty. The FSA considered that the following factors are particularly relevant in this case.

Deterrence (DEPP 6.5.2(1))

5.5. In determining the level of the financial penalty, the FSA had regard to the need to ensure those who are approved persons exercising management functions act with the businesses in accordance with regulatory requirements and standards and to behave towards the FSA in an open and cooperative manner. The FSA considered that a penalty should be imposed to demonstrate to you and others the seriousness with which the FSA regards such behaviour.

The nature, seriousness and impact of the breach in question (DEPP 6.5.2(2))

5.6. Your failures exposed customers to a risk of receiving unsuitable recommendations in relation to retail investment products. Due to your failure to take reasonable steps to ensure that the LLP retained appropriate records to demonstrate whether its advisers

assessed and, if so, the basis on which its advisers assessed the suitability of the products they recommended, the FSA was unable to satisfy itself that customers were recommended suitable investment products.

The extent to which the breach was deliberate or reckless (DEPP 6.5.2(3))

5.7. The FSA concluded that your contraventions were not deliberate. However, the FSA considered that the nature of your actions (and inaction) as set out in section 4 of this Notice amounted to serious misconduct.

Whether the person on whom the penalty is to be imposed is an individual (DEPP 6.5.2(4))

5.8. When determining the appropriate level of financial penalty, the FSA will take into account that individuals will not always have the same resources as a body corporate, that enforcement action may have a greater impact on an individual, and further, that it may be possible to achieve effective deterrence by imposing a smaller penalty on an individual than a body corporate. The FSA will also consider whether the status, position and/or responsibilities of the individuals are such as to make a breach committed by the individual more serious and whether the penalty should therefore be set at a higher level.

5.9. The FSA recognised that the financial penalty imposed on you was likely to have a significant impact on you as an individual but it was considered to be proportionate in relation to the seriousness of the misconduct and given your position as an approved person performing significant influence functions at the LLP.

The size, financial resources and other circumstances of the person on whom the penalty is to be imposed (DEPP 6.5.2(5))

5.10. The FSA considered that the financial penalty described above was appropriate, having taken account of all relevant factors.

The amount of benefit gained or loss avoided (DEPP 6.5.2.G(6))

5.11. The FSA did not establish that you obtained any financial benefit or avoided any loss as a result of the breaches.

Conduct following the breach (DEPP 6.5.2G(8))

5.12. The FSA noted your co-operation with the FSA's investigation in that you attended an interview and answered the investigators' questions, but it also took into account your failure to reply to all document requests.

Disciplinary record and compliance history (DEPP 6.5.2G(9))

5.13. The FSA took into account the fact that you have not been the subject of previous disciplinary action by the FSA.

Other action taken by the FSA (DEPP 6.5.2G(10))

5.14. The FSA has taken action against other approved persons for similar misconduct.

5.15. The FSA therefore decided to impose a financial penalty of £25,000 on you, reduced to £17,500 to take account of the settlement discount described above.

Withdrawal of approval and prohibition

5.16. The FSA had regard to the guidance in Chapter 9 of the Enforcement Guide (EG) in deciding that a Prohibition Order, Time Limited Prohibition Order and a withdrawal of approval were appropriate in this case. The relevant provisions of EG are set out in Annex A of this notice.

5.17. Given the nature and seriousness of the failures outlined above, the FSA concluded that you were not competent and capable to perform significant influence functions at an authorised firm. As such you were not fit and proper to perform such functions. It was therefore decided that your individual approval should be withdrawn and you should be prohibited from performing such functions in the interest of protecting consumers.

6. CONCLUSIONS

6.1. On the basis of the facts and matters described above, the FSA concluded that your conduct fell short of the minimum regulatory standards required of an approved person and that you breached Statements of Principle 2 and 7.

6.2. The FSA, having regard to all the circumstances, therefore decided that it was appropriate and proportionate to impose a financial penalty of £17,500 on you, to withdraw your approval and to make the Prohibition Order and Time Limited Prohibition Order against you. The effective date of the sanctions in this Final Notice is 25 November 2010.

7. DECISION MAKER

7.1. The decision which gave rise to the obligation to give this Final Notice was made on behalf of the FSA by Settlement Decision Makers for the purposes of the FSA's Decision Procedure and Penalties Manual.

8. IMPORTANT

8.1. This Final Notice is given to you in accordance with section 390 of the Act.

Manner and time of payment

8.2. The financial penalty must be paid in full by you to the FSA by no later than 9 December 2010, 14 days after the date of this Final Notice.

If the financial penalty is not paid

8.3. If all or any of the financial penalty is outstanding on the due date, the FSA may recover the outstanding amount as a debt owed by you and due to the FSA.

Publicity

8.4. Sections 391(4), 392(6) and 391(7) of the Act apply to the publication of information about the matter to which this Final Notice relates. Under those provisions, the FSA must publish such information about the matter to which this Notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interests of consumers.

8.5. The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

FSA contacts

8.6. For more information concerning this matter generally, you should contact Chris Walmsley at the FSA (direct line: 020 7066 5894/ fax: 020 7066 5895).

Tom Spender
Head of Department
Enforcement and Financial Crime Division

ANNEX A

RELEVANT STAUTORY PROVISIONS, REGULATORY REQUIREMENTS AND FSA GUIDANCE

1. Statutory provisions

1.1. The FSA's statutory objectives, set out in Section 2(2) of the Act, include the protection of consumers.

1.2. The FSA has the power, by virtue of section 66 of the Act, to impose a financial penalty on you of such amount as it considers appropriate where it appears to the FSA that you are guilty of misconduct and it is satisfied that it is appropriate in all the circumstances to take action against you.

1.3. You are guilty of misconduct if, while an approved person, you fail to comply with a statement of principle issued under section 64 or have been knowingly concerned in a contravention by the relevant authorised person of a requirement imposed on that authorised person by or under the Act.

1.4. Pursuant to section 63 of the Act, the FSA has the power to withdraw the approval given to you under section 59 of the Act – to perform the significant controlled functions of CF4 Partner, CF10 Compliance Oversight and CF11 Money Laundering Reporting – if it considers that you are not a fit and proper person to perform them.

2. APER Statements of Principle for Approved Persons

2.1. APER is issued pursuant to section 64 of the Act. It sets out Statements of Principle with which approved persons are required to comply when performing a controlled function for which approval has been sought and granted. They are general statements of the fundamental obligations of approved persons under the regulatory system. APER also contains descriptions of conduct which, in the opinion of the FSA, constitutes a failure to comply with a particular Statement of Principle and describes factors which the FSA will take into account in determining whether an approved person's conduct complies with it.

2.2. APER 3.1.3G states, as guidance, that, when establishing compliance with, or breach of, a Statement of Principle, account will be taken of the context in which a course of conduct was undertaken, the precise circumstances of the individual case, the characteristics of the particular controlled function and the behaviour expected in that function.

2.3. APER 3.1.4G states, as guidance, that an approved person will only be in breach of a Statement of Principle if they are personally culpable, that is in a situation where their conduct was deliberate or where their standard of conduct was below that which would be reasonable in all the circumstances.

2.4. In this case, the FSA considers the most relevant Statements of Principle to be Statement of Principle 2 and Statement of Principle 7.

2.5. Statement of Principle 2 requires that an approved person must act with due skill, care and diligence in carrying out his controlled function.

2.6. Statement of Principle 7 requires that an approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system.

2.7. APER 4.2.2E to 4.2.13E provide examples of the types of behaviour that, in the opinion of the FSA, do not comply with Statement of Principle 2. These include**:**

(1) failing to inform a customer of material information in circumstance where the approved person ought to have been aware of such information and of the fact that he should provide it, including failing to explain the risks of an investment to a customer (APER 4.2.3E and 4.2.4E);

(2) recommending an investment to a customer where the approved person does not have reasonable grounds to believe that it is suitable for that customer (APER 4.2.5E); and

(3) recommending transactions without a reasonable understanding of the risk exposure of the transaction to a customer including where that recommendation is made without a reasonable understanding of the liability (either potential or actual) of the transaction (APER 4.2.6E and 4.2.7E)).

2.8. APER 4.7.2E to 4.7.10E provide examples of the types of behaviour that, in the opinion of the FSA, do not comply with Statement of Principle 7. These include:

(1) failing to take reasonable steps to implement (either personally or through a compliance department or other departments) adequate and appropriate systems of control to comply with the relevant standards of the regulatory system in respect of the relevant firm's regulated activities (APER 4.7.3E);

(2) failing to take reasonable steps to monitor (either personally or through a compliance department or other departments) compliance with the relevant requirements and standards of the regulatory system in respect of the relevant firm's regulated activities (APER 4.7.4E); and

(3) in the case of an approved person performing a significant influence function responsible for compliance, failing to take reasonable steps to ensure that appropriate compliance systems and procedures are in place (APER 4.7.10E).

3. FSA's policy on exercising its power to impose a financial penalty

3.1. The FSA's statement of policy with respect to the imposition and amount of penalties under the Act, as required by sections 69(1), 93(1), 124(1) and 210(1) of the Act, and guidance on those matters is provided in Chapter 6 of the FSA's Decision Procedure and Penalties Manual ("DEPP"), entitled "Penalties", which is part of the FSA's Handbook. In summary, chapter 6 of DEPP states that the FSA will consider the full circumstances of each case when determining whether or not to take action for a financial penalty, and sets out a non-exhaustive list of factors that may be relevant for this purpose.

3.2. The principal purpose of imposing a financial penalty is to promote high standards of regulatory conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches and demonstrating generally the benefits of compliant behaviour.

3.3. The FSA will consider the full circumstances of each case when determining whether or not to take action for a financial penalty. DEPP6.2.1G sets out guidance on a non-exhaustive list of factors that may be of relevance in determining whether to take action for a financial penalty, which include the following.

(1) DEPP 6.2.1G(1): The nature, seriousness and impact of the suspected breach.

(2) DEPP 6.2.1G(2): The conduct of the person after the breach.

(3) DEPP 6.2.1G(3): The previous disciplinary record and compliance history of the person.

(4) DEPP 6.2.1G(4): FSA guidance and other published materials.

(5) DEPP 6.2.1G(5): Action taken by the FSA in previous similar cases.

4. Determining the level of the financial penalty

4.1. The FSA will consider all the relevant circumstances of a case when it determines the level of financial penalty. DEPP 6.5.2G sets out guidance on a non exhaustive list of factors that may be of relevance when determining the amount of a financial penalty.

4.2. Factors that may be relevant to determining the appropriate level of financial penalty include:

(1) whether the breach revealed serious or systematic weaknesses in the person's procedures or of the management systems or internal controls relating to all or part of a person's business (DEPP 6.5.2G(2)(b)); and

(2) the general compliance history of the person, including whether the FSA has previously brought to the person's attention, issues similar or related to the conduct that constitutes the breach in respect of which the penalty is imposed (DEPP 6.5.2(9)(d)).

5. Fit and Proper Test for Approved Persons

5.1. The part of the FSA Handbook entitled "FIT" sets out the Fit and Proper Test for Approved Persons. The purpose of FIT is to outline the main criteria for assessing the fitness and propriety of a candidate for a controlled function. FIT is also relevant in assessing the continuing fitness and propriety of an approved person.

5.2. FIT 1.3.1G provides that the FSA will have regard to a number of factors when assessing a person's fitness and propriety. One of the considerations will be the person's competence and capability.

5.3. As set out in FIT 2.2, in determining a person's competence and capability, the FSA will have regard to matters including but not limited to:

(1) whether the person satisfies the relevant FSA training and competence requirements in relation to the controlled function the person performs or is intended to perform; and

(2) whether the person has demonstrated by experience and training that the person is able, or will be able if approved, to perform the controlled function.

6. FSA's policy for exercising its power to make a prohibition order and withdraw a person's approval

6.1. The FSA's approach to exercising its powers to make prohibition orders and withdraw approvals is set out at Chapter 9 of the Enforcement Guide ("EG").

6.2. EG 9.1 states that the FSA's power to make prohibition orders under section 56 of the Act helps it work towards achieving its regulatory objectives. The FSA may exercise this power where it considers that, to achieve any of those objectives, it is appropriate either to prevent an individual from performing any functions in relation to regulated activities or to restrict the functions which he may perform.

6.3. EG 9.4 sets out the general scope of the FSA's powers in this respect, which include the power to make a range of prohibition orders depending on the circumstances of each case and the range of regulated activities to which the individual's lack of fitness and propriety is relevant. EG 9.5 provides that the scope of a prohibition order will vary according to the range of functions which the individual concerned performs in relation to regulated activities, the reasons why he is not fit and proper and the severity of risk posed by him to consumers or the market generally.

6.4. In circumstances where the FSA has concerns about the fitness and propriety of an approved person, EG 9.8 to 9.14 provides guidance. In particular, EG 9.8 states that the FSA may consider whether it should prohibit that person from performing functions in relation to regulated activities, withdraw that person's approval or both. In deciding whether to withdraw approval and/or make a prohibition order, the FSA will consider whether its regulatory objectives can be achieved adequately by imposing disciplinary sanctions.

6.5. EG 9.9 states that the FSA will consider all the relevant circumstances when deciding whether to make a prohibition order against an approved person and/or to withdraw that person's approval. Such circumstances may include, but are not limited to, the following factors:

(1) whether the individual is fit and proper to perform functions in relation to regulated activities, including in relation to the criteria for assessing the fitness and propriety of an approved person in terms of competence and capability as set out in FIT 2.2;

(2) the relevance and materiality of any matters indicating unfitness;

(3) the length of time since the occurrence of any matters indicating unfitness;

(4) the particular controlled function the approved person is (or was) performing, the nature and activities of the firm concerned and the markets in which he operates;

(5) the severity of the risk which the individual poses to consumers and to confidence in the financial system; and

(6) the previous disciplinary record and general compliance history of the individual.

6.6. EG 9.12 provides a number of examples of types of behaviour which have previously resulted in the FSA deciding to issue a prohibition order or withdraw the approval of an approved person. The examples include serious lack of competence.

7. Conflict of interest

7.1. Statement of Principle 8 requires that a firm must manage conflicts of interest fairly, both between itself and its customer and between a customer and another client.

8. Complaints handling rules

8.1. DISP 1.3.1 R in the part of the Handbook entitled Dispute Resolution: Complaints ("DISP") requires that effective and transparent procedures for the reasonable and

prompt handling of complaints must be established, implemented and maintained by the respondent.

8.2. DISP 1.4.1 R requires that once a complaint has been received by a respondent, it must

(1) investigate the complaint competently, diligently and impartially,

(2) assess fairly, consistently and promptly the subject matter of the complaint, whether the complaint should be upheld, what remedial action or redress (or both) may be appropriate and, if appropriate, whether it has reasonable grounds to be satisfied that another respondent may be solely or jointly responsible for the matter alleged in the complaint.

8.3. DISP 1.6.1 R requires that on receipt of a complaint**:**

(1) a respondent must send the complainant a prompt written acknowledgement providing early reassurance that it has received the complaint and is dealing with it, and

(2) ensure the complainant is kept informed thereafter of the progress of the measures being taken for the complaint's resolution.

8.4. DISP 1.6.2 R requires that the respondent must, by the end of eight weeks after its receipt of the complaint, send the complainant:

(1) a final response; or

(2) a written response which explains why it is not in a position to make a final response and indicate when it expects to be able to provide one, inform the complainant that he may now refer the complaint to the FOS, and enclose a copy of the FOS standard explanatory leaflet.

ANNEX B

9. Promotion of collective investment schemes

9.1. Section 238(1) of the Act provides that an authorised person must not communicate an invitation or inducement to participate in a collective investment scheme ("CIS"), and therefore also an UCIS. Section 21 of the Act imposes an equivalent restriction in relation to unauthorised persons.

9.2. Section 238 goes on expressly to carve out circumstances where this prohibition will not apply. These include:

(1) Where the CIS in question is an authorised unit trust/open ended investment company or a recognised scheme (s238 (4)).

(2) The Treasury may by order specify circumstances (s238 (6) - i.e. there is a statutory exemption in an order made by the Treasury - the FSMA 2000 (Promotion of Collective Investment Schemes (Exemptions) Order 2001 ("PCIS Order");

(3) The financial promotion is permitted under FSA rules exempting the promotion of UCIS under certain circumstances (s238 (5) (COBS 4.12)

9.3. The PCIS Order provides for authorised firms to promote UCIS to individuals if they fall within a particular category of exemption set out in the order.

9.4. These exemptions pertain to a certain category of individuals, for example certified high net worth individuals, certified sophisticated investors or self-certified sophisticated investors (articles 21, 23 and 23A of the PCIS Order).

10. The PCIS Order exemptions - Certified high net worth individuals

10.1. Article 21(2) defines a certified high net worth individual as being an individual who has signed a statement complying with Part I of the Schedule to the PCIS Order in the past 12 months. Essentially this requires that at least one of the following sets of circumstances apply:

(1) The person had, during the previous financial year immediately preceding the date of the statement, an annual income of £100,000 or more; and/or

(2) The person held, throughout the previous financial year immediately preceding the date of the statement, net assets to the value of £250,000 or more, not including that person's primary residence or any loan secured on that residence; that person's rights under a qualifying contract of insurance within the meaning of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (a); or any benefits (in the form of pensions or otherwise) which are

payable on the termination of that person's service or on that person's death or retirement and to which that person is (or that person's dependants are), or may be, entitled.

10.2. The statement also requires that the person signs a statement to indicate he accepts that he can lose his property and other assets from making investment decisions based on financial promotions and is aware it is open to him to seek specialist advice.

10.3. If the person making the communication believes on reasonable grounds that he is making it to a certified high net worth individual, then the section 238 restriction will not apply as long as the communication:

(1) is a non-real time communication or a solicited real time communication;

(2) relates only to units in a UCIS which invests wholly or predominantly in the shares in or debentures of one or more unlisted companies;

(3) does not invite or induce the recipient to enter into an agreement under the terms of which he can incur a liability or obligation to pay or contribute more than he commits by way of investment;

(4) a specified warning in the following terms is given both orally (in respect of a real-time communication) and in writing in the manner prescribed in Article 21:

"Reliance on this promotion for the purpose of buying the units to which the promotion relates may expose an individual to a significant risk of losing all of the property or other assets invested."; and

(5) is accompanied by an indication that the promotion is exempt from section 238 on the grounds that it is communicated to a certified high net worth individual, together with details of the requirements for certified high net worth investors and a reminder that the individual should consult a specialist if in any doubt about participating in a UCIS.

10.4. There are similar provisions for high net worth companies and associations at Article 22.

11. The PCIS Order exemptions - Sophisticated investors

11.1. There are two sorts of sophisticated investors referred to in the PCIS Order – certified and self-certified.

Certified sophisticated investors

11.2. A certified sophisticated investor is defined in Article 23(1) as someone:

(1) Who has a current certificate (signed and dated in the past three years) in writing or other legible form signed by an authorised person to the effect that he is sufficiently knowledgeable to understand the risks associated with participating in a UCIS; and

(2) Who has signed, within the previous 12 months, a statement in the following terms

"I make this statement so I can receive promotions which are exempt from the restriction on promotion of unregulated schemes in the Financial Services and Markets Act 2000. The exemption relates to certified sophisticated investors and I declare that I qualify as such. I accept that the schemes to which the promotions will relate are not authorised or recognised for the purposes of that Act. I am aware that it is open to me to seek advice from an authorised person who specialises in advising on this kind of investment."

11.3. The communication must be accompanied by an indication that section 238 does not apply, of the requirements to be a certified sophisticated investor, a prescribed risk warning and a reminder to seek independent advice.

11.4. Provided all this is met, and the communication is not to participate in a UCIS carried on by the person who certified the investor as sophisticated, then the section 238 restriction will not apply.

Self-certified sophisticated investors

11.5. Article 23A defines a self-certified sophisticated investor as an individual who has signed a statement complying with Part II of the Schedule to the PCIS Order in the past 12 months. Essentially this requires that at least one of the following sets of circumstances applies to the investor:

(1) He is a member of a network or syndicate of "business angels" and has been so for at least the last six months;

(2) He has made more than one investment in an unlisted company in the past two years;

(3) He is working, or has worked in the past two years, in a professional capacity in the private equity sector, or in the provision of finance for small and medium enterprises;

(4) He is currently, or has been in the two years before signing the statement, a director of a company with an annual turnover of at least £1 million.

11.6. As with high net worth individuals, the statement also requires the investor to sign a statement that he accepts he can lose his property and assets from making investment

decisions based on financial promotions and that he is aware that it is open to him to seek specialist advice.

11.7. If the person making the communication believes on reasonable grounds that he is making it to a self-certified sophisticated investor, then the section 238 restriction will not apply as long as the communication:

(1) relates only to units in a UCIS which invests wholly or predominantly in the shares in or debentures of one or more unlisted companies;

(2) does not invite or induce the recipient to enter into an agreement under the terms of which he can incur a liability or obligation to pay or contribute more than he commits by way of investment;

(3) a specified warning in the following terms is given both orally (in respect of real time communications) and in writing in the manner prescribed in Article 23A:

"Reliance on this promotion for the purpose of buying the units to which the promotion relates may expose an individual to a significant risk of losing all of the property or other assets invested."; and

(4) is accompanied by an indication that the promotion is exempt from section 238 on the ground that it is made to a self-certified sophisticated investor, together with details of the requirements for self-certified sophisticated investors and a reminder that the individual should consult a specialist if in any doubt about participating in a UCIS.

12. The COBS exemptions

12.1. A firm may communicate an invitation or inducement to participate in a UCIS without breaching the section 238 restriction if the promotion falls within an exemption listed in the table at 4.12.1R(4) of the Conduct of Business Sourcebook (COBS).

12.2. The inducement or invitation must be made only to recipients whom the firm has taken reasonable steps to establish are persons in that category or be directed at recipients in such a way as to reduce, as far as possible, the risk of participation in the CIS by persons not in that category. There is no provision for these steps to be taken retrospectively.

12.3. Category 1 covers people who are already participants in a UCIS or have been so in the last 30 months. An authorised person can promote to these persons the UCIS in which they are already participants (and any successor scheme) or one whose underlying property and risk profile are both "substantially similar" to those of the UCIS in which they participate.

12.4. Category 2 deals with those persons for whom the firm has taken reasonable steps to ensure that investment in the UCIS is suitable and who is a client of the firm or a company in its group.

12.5. Category 7 provides that if a client is categorised as a professional client or eligible counterparty then an authorised person can promote to that client any UCIS in relation to which the client is so categorised.

12.6. Category 8 allows financial promotion of UCIS to a person:

(1) In relation to whom the firm has undertaken an adequate assessment of his expertise, experience and knowledge and that assessment gives reasonable assurance, in light of the nature of the transactions or services envisaged, that the person is capable of making his own investment decisions and understanding the risks involved;

(2) To whom the firm has given a clear written warning that this will enable the firm to promote UCIS to the client; and

(3) Who has stated in writing, in a document separate from the contract, that he is aware of the fact the firm can promote certain UCIS to him.

13. Suitability of advice

13.1. The fact that a customer is eligible to receive a communication promoting a UCIS under one or more exemptions does not mean that UCIS will be automatically suitable to that customer.

13.2. Principle 9 of the FSA's Principles for Businesses states a firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.

13.3. In considering the suitability of a particular scheme for a specific client, a firm is required by COBS 9 to obtain the necessary information to understand the essential facts about the client (COBS 9.2.2R).

13.4. COBS 9.2.6R provides that if a firm does not obtain the necessary information to assess suitability, it must not make a personal recommendation to the client.